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Audit's MARKET ANALYSIS OF SECURITIES OF REITS AND REAL ESTATE COMPANIES

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Realty Stock Review

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MARKET STRATEGY: VALUE CREATION AND RECOVERY REMAIN MAJOR INVESTMENT THEMES

The June quarter was more of the same for realty stocks: whipsawed by untamed interest rates and constant pressure from many overbuilt office markets.

Not that anything was easy in the quarter. Investment demand continued to favor blue chips and the Dow-Jones Industrials rose 4.9% for the quarter, tame by the 20%-plus gains of the previous quarter. The broader S&P 500 Index moved up 4.2% while the NASDAQ OTC Composite actually fell, by 1.3%.

Against this backdrop blood flowed in the homebuilder and mortgage stocks. REITs fared a bit better than operating companies. The advance/decline count:

	Advances	Declines	Unchanged
REITs....	31	67	5
Oper.Co..	19	100	3

The list of biggest percentage winners and losers underscore two themes:

--Quality equity REITs remained in favor, with four placing in the top 10: **Cousins** (new to REIT ranks), **Bradley** (less widely traded), **Pennsylvania** and **First Union.** Other well known equity trusts in plus territory were **BankAmerica Realty** (becoming self-administered), **New Plan Realty,** and **Santa Anita.** We think it makes sense to stay with them.

--Recovery REITs are prominent with **Weingarten Realty** and **Property Trust of America,** two Southwestern based trusts, up. **HMG Property** and **USP REIT** both snapped out of long declines, and **Americana Hotels** was strong, ranking No. 11.

Playing recovery remains tricky however as **CleveTrust Realty** and two large ConCap trusts, **Income Trust** and **Special Trust,** both gave ground. ConCap Income defeated a hostile proxy contest in the quarter. We prefer staying with the best capitalized of the group.

BIGGEST PERCENTAGE GAINERS-JUNE QTR.

REITS			Operating Cos.		
Stock	Price	%	Stock	Price	%
1.HMG Prop.	$9.88	+20%	Wespac..	$2.38	+46
2.Weingrtn.	28.00	+12	US Shlt..	2.63	+31
3.Cousins..	15.00	+11	SantaFe.	50.00	+25
4.USP REIT.	9.50	+10	Sunstat.	15.00	+24
5.MDC Aset.	17.38	+ 9	LandTec.	4.00	+14
6.Bradley..	14.88	+ 8	CastleC.	23.75	+13
7.Meditrst.	20.25	+ 8	Tierco..	7.00	+12
8.PennREIT.	25.75	+ 8	Grubb&El	6.13	+11
9.Pr.Tr.Am.	10.25	+ 8	Hallwod.	24.38	+ 8
10.FirstUn.	27.13	+ 7	Intergr.	11.63	+ 8

BIGGEST PERCENTAGE LOSERS-JUNE QTR.

1.L&N Hsg.	$18.13	-27	Farragt.	$5.00	-55
2.CleveTrs.	10.00	-26	NVRyan...	9.63	-54
3.Sierra'84.	7.00	-25	Gemcraft.	4.00	-50
4.Coun.Mtg.	12.25	-20	Covingtn.	1.00	-43
5.ConCapIn.	12.00	-19	Levitt...	8.75	-43
6.Mtg.InP1..	7.00	-16	Cont.HmH.	8.50	-41
7.ConCapSp1.	7.75	-16	Radice...	5.38	-39
8.Linpro Sp.	8.13	-16	Patten..	16.63	-35
9.Lomas Mt.	23.25	-15	Amer.R1..	5.25	-34
10.Nat.Cap..	2.25	-14	Nat.Entr.	3.63	-34

RANKING REVIEW ISSUE

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NOW AVAILABLE: Our revised brochure describing our money management services.

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WHAT'S AHEAD FOR MLPS? WE SEE BIG CHANGE AHEAD AS CONGRESS WEIGHS IRS TIGHTENING

We hate to write the above headline but our professional view is that the operation of master limited partnerships, as they have evolved in today's stock market, is drawing to a close. That is our unvarnished opinion, which you pay us to deliver.

MLPs have emerged as an escape from double taxation during the 1980s, appearing first in the oil industry and then in real estate. In the past two years more operating businesses have switched, including many homebuilders (**NVRyan, Standard Pacific** and **UDC-Universal**), hotel and restaurant operators, and even a basketball team, the Boston Celtics.

Various writers have predicted that America's blue chips will disincorporate and become MLPs but the 1986 Tax Reform Act effectively barred that possibility by repealing the General Utilities Doctrine and thereby triggering major tax liabilities for any converting company. Despite this, pressure continues for Congress to "close the loophole" and in that spirit a House subcommittee held hearings last week.

At those hearings the Treasury proposed taxing all public master limited partnerships with the exception of those in the oil and gas industry (a tip of the hat to powerful oil state politicians). Treasury wants Congress to bring all non-energy MLPs under corporate taxes without grandfathering those in existence.

Real estate interests have been pressing for a similar exemption (because much real estate is already organized in partnership form) but Treasury so far has refused. Congress could grant such an exemption. Failing an exemption, realty interests are likely to push for (and could win) grandfathering of existing MLPs in real estate.

Our sources indicate Treasury is likely to win at an administrative level, unless Congress explicitly approves MLPs and sets out definitive rules. IRS could make MLPs unworkable and impractical simply by toughening processing and auditing of already-complex MLP tax returns. Since auditing of an MLP return lets IRS audit returns of all limited partners, public unitholders could be surprised.

We aren't ready to panic and write off MLPs but we think investors should exercise extra caution until the fight in Congress clarifies. If Congress does clamp down, one likely result would be that many existing MLPs might go private or switch to REIT status. Treasury officers tell inquirers that Congress created REITs (real estate investment trusts) and REMICs (real estate mortgage investment conduits) as the preferred tax-exempt vehicles for real estate investment and that's the law until and unless Congress changes its mind.

RANKING REVIEWS: FIVE MAJOR INVESTMENT BUILDERS HANDLING TODAY'S TOUGH MARKETS

We review this issue six investmetn builders: three post current asset values for investors and two sell below NAV (Unicorp and Perini Inv.) while a third sells (Koger) sells above NAV.

Koger Company ($30.63--ASE) retains A Rank. This Jacksonville based company buys suburban office parks developed by affiliated Koger Properties Inc.

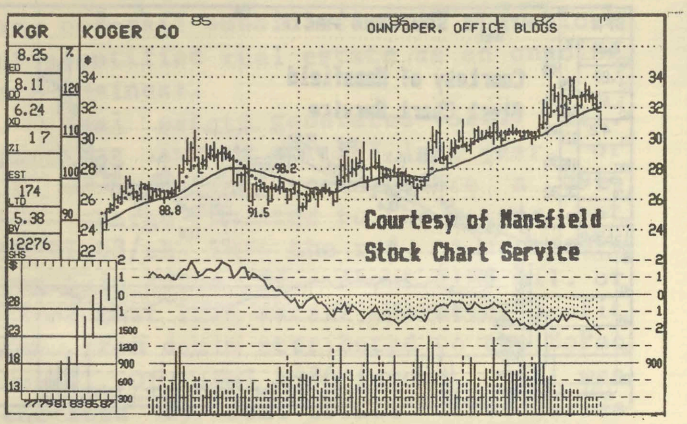
EPS/Dividends - A (Dec. years):

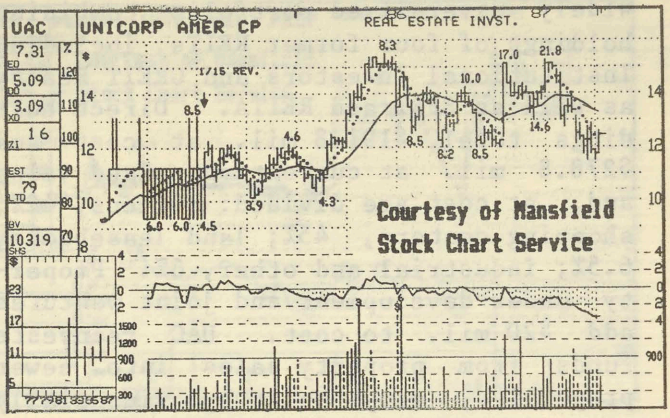
	1985A	1986A	1987E	3 Yr.%
EPS/Oper...	$0.13	$0.26	$0.20	NM
CFS/Oper*..	$2.37	$2.42	$2.50	2.7%
Dividends..	$2.32	$2.38	$2.40	1.7

* Gross cash flow; see below.

KGR operating earnings above are under general accounting principles, which has far less meaning than operating cash flow. Net cash flow computed by KGR was $2.42/sh., up 2%, and includes deferred taxes, accrued incentive compensation and additional interest on real estate appreciation notes. KGR earned 3¢ in the Mar. qtr., up 50%, and cash flow computed by KGR of 61¢ sh. rose 3%. KGR paid $2.38/sh. dividends in 1986, all taxfree return of capital, and currently pays a $2.40 rate.

Assets: KGR is the public property owning entity which buys Sunbelt office





buildings periodically from Koger Properties, Inc. (KOG), the developer and property manager. KGR owns 163 office buildings with 4.46 mil. sq. ft. at $316 mil. total cost, or $70.88/SF average. All are in suburban office parks developed by KOG in 12 Sunbelt cities divided by space: Florida 42.0%, in Jacksonville, Orlando, St. Petersburg, and Tallahassee; Texas 24.6%, in Austin, El Paso and San Antonio; Georgia 13.9%, all Atlanta; N.Caro. 10.1%, in Charlotte and Greensboro; Okla. 7.2%, all Tulsa; and S.Caro. 2.2%, all Greenville. KOG is building 29 additional buildings in the 12 parks and KGR expects to buy them thru 1989.

Operations: KGR's buildings were 96% occupied at Mar. 1987, up 2% for the year. Leasing was strong in the first quarter and KGR says effective rents rose 2.5% in 1986. KGR leases to over 2,100 tenants. Leases generally are for 3-5 years and 81% of leases expiring in 1986 were renewed, evidence of KGR's strong leasing muscle. Leases for 30.5% of space expire in 1987.

Financial Measures - A: Debt of $157.7 mil. at Mar. 1987 is 2.1 times $76.2 mil. shareholders' equity at cost and 0.6 times equity at current appraised value. Equity at cost is $6.20/sh. Debt is 31% fixed rate mortgages on properties; 21% real estate appreciation notes; and 48% of 8.4% senior notes sold in Jan. KGR has in turn loaned $41.6 mil. to KOG to partially finance construction of buildings for its eventual purchase.

Current Value: KGR's independent appraiser valued KGR stock at $255.2 mil. or $20.65/sh. net of debenture discounts subtracted by Audit.

Exposure - A: KGR has been able to sustain cash flow growth, albeit at a slower pace recently, in overbuilt Sunbelt office markets by buying properties built by affiliate Koger Properties only when 90% leased, and drawing upon a base of national tenants to maintain leasing. This formula lets KGR rent at about 10% below most markets and thus keep buildings full even in face of overbuilding. Conservative leverage and tax-sheltered distributions of most cash flow give the stock good liquidity; recent decision to expand debt while limiting sales of new shares should benefit holders long-term, even with slower recent growth.

Unicorp American Corp. ($12.50--ASE) holds B Rank in our annual review. This amalgamation of several former REITs is making a strong entry into financial services; income remains dominated by property sale gains.

EPS/Dividends - B (Dec. years):

	1985A	1986A	1987E	3 Yr.%
EPS/Oper...	$2.43	$0.89	NA	NM
CFS/Oper...	$4.01	$1.45	$1.50	NM
Dividends..	$0.00	$0.60	$0.60	NM

UAC earnings after preferred dividends fell in 1986, mainly because gains on property sales fell 51% from $2.17 to $1.07 per share. UAC also did not have taxloss carryforwards available in 1986, source of $1.12/sh. cash flow in 1985. This reliance upon large capital gains is in line with UAC's policy of selling off older properties, mainly those acquired when UAC merged two former REITs, San Francisco Realty Inv. and REIT of America in 1983 and 1984. UAC began a 60¢ sh. annual dividend in Feb. 1986 to win institutional investor support.

Assets and Operations: UAC holds a

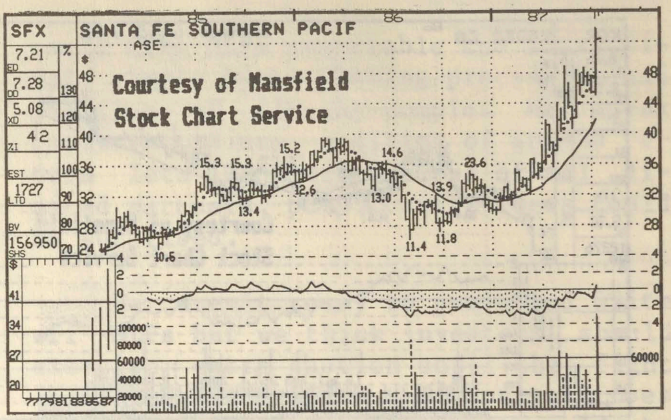
widely diversified portfolio combining holdings of four former REITs, including Institutional Investors and GREIT Realty as well as SFRI and REITA. Direct holdings total $191.8 mil. at cost and $278.8 mil. at current appraised value and, at cost are divided: offices, 42%; shopping centers, 45%; land leasebacks, 6.5%; industrial and other, 6%. Property under development and joint ventures add $20 mil. to cost. UAC reinvests funds from property sales into newer properties, many built by financially weak developers, deemed to have more potential for capital gains in future years thru renovation and remerchandising. Major sectors:

Office buildings: UAC holds 16 office buildings with 2.2 mil. sq. ft. with 18.3% vacancy at year-end, up from 11.6% a year ago. Most vacancies are in properties being renovated. Major vacancies are in 479,000 SF Colorado Bank Bldg., Denver, 14% vacant; 112,000 SF Mobil & Texaco Bldg., Corpus Christi, Tex., 71% vacant; and 200,000 SF Petroleum Bldg., Denver, 28% vacant. UAC is studying redeveloping the Texas buildings and is renovating and expanding 212,000 SF Tremont Bldg. in Boston. Offices cost an average $36.65/SF.

Shopping centers: UAC owns 10 centers with 1.69 mil. sq. ft. with 9.3% overall vacancy, down from 13.5%. Most are a package of seven centers in the San Antonio area with 983,000 net SF bought for $63 mil. ($64.08/SF) in 1985. The package includes five neighborhood centers with 210,150 SF (25% vacant); one community center with 233,000 SF (17% vacant); and 540,000 SF SouthPark enclosed mall regional center (7% vacant). Hillside Ctr. in Chicago with 471,000 SF was renovated in 1985 and vacancy cut to 5%.

Financial services: UAC has agreed to pay $150 mil. to buy 90% of Lincoln Savings Bank, a $2.3 bil. Manhattan savings bank; to invest $23 mil. into a 43% interest in American Medical Buildings (Symbol A--ASE) builder and syndicator of healthcare facilities; and to commit $18 mil. to a joint venture for mortgage and real estate transactions with Sybedon Corp. of Manhattan.

Financial Measures - A: Debt of $90.9 mil. is 0.6 times $144.8 mil.



shareholders' equity (including preferred) at cost, and 0.4 times $204.7 equity at current market value. Debt is 69% long-term fixed rate mortgage, the rest variable rate short-term. UAC called all preferred in 1986 except one issue held by Unicorp Canada Corp. Book value is $12.36 per share.

Current value: An outside appraiser values UAC's property and mortgage assets and liabilities at net equity value of $17.66/sh.

Exposure - A: UAC's property strategy is to add value fairly quickly and then sell properties for profits, not to hold for long-term appreciation. In this context value added as measured by current value appears the best focus for investors. UAC sees part of its future in financial services and has agreed to buy a major Manhattan savings bank. This will involve assumption of significantly higher leverage and could increase risk character of UAC common.

Santa Fe Southern Pacific ($50.50--NYSE) is a major Western railroad holding company and land play that has attracted major investment interest now that the I.C.C. has denied its plan to merge its two major railroads, the Santa Fe and the Southern Pacific. One railroad must be sold within two years and SFX hasn't said which one will go, altho SoPac earnings have been held in trust pending the I.C.C. decision and is the logical candidate. With this uncertainty, we are suspending SFX' Ranking.

While the big news is in railroading, SFX very much is a major league real estate play. How that shakes out in the divestiture remains to be seen. In the decision's aftermath, SFX put

six non-rail subsidiaries on the block but identified real estate as an ongoing core business.

Real estate generated $321.7 mil. operating income for SFX last year, or 62% of operating income before a $914 mil. charge related to the merger put SFX $1.63/sh. into the red. A nonrecurring gain added 79¢. About $186 mil. or 37% of that real estate operating profit came from deals attributed to the SoPac trust. Of total 1986 income, 48% was generated by real estate subsidiaries (38% property sales, 9% rentals, 4% joint ventures) and 52% came from real estate income of non-real estate subsidiaries. How much will be lost as the omelette is unscrambled isn't clear.

What's clear is that SFX owns a pot full of valuable properties, estimated to be worth $5 bil. or more (or about $31.85/sh. before debt allocation). SFX owns 8.2 mil. sq. ft. of industrial and office space, 28,500 commercial/industrial acres under lease, and 158,000 acres of farmland. Major holdings include 440,000 SF McDonnell Douglas Center, San Jose; 46.5% of 759,000 SF Pacific Design Center in Hollywood, Cal., being expanded by 450,000 SF; and 209 acres near downtown San Francisco being planned as a major multiuse project.

There's some indication the new SFX will stress sales of income properties, instead of land as has been the case. We have carried SFX in our Portfolio Selector for two years now and think it's a strong hold, if not a buy at these elevated prices.

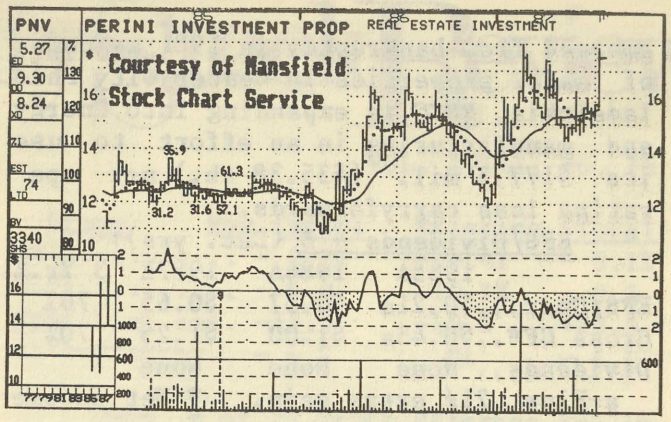
Perini Investment Properties Inc. ($17.13--ASE) has been growing since its 1984 spinoff from contractor Perini Corp. and the common touched a record $18 early this year and nearly equaled that figure last week. We are ranking PNV at B initially.

EPS/Dividends - B (Dec. yrs.:

	1985A	1986A	1987E	3 Yr.%
EPS/Oper.	($0.08)a	($0.44)a	($0.30)a	NM
CFS/Oper.	$0.80a	$1.00a	$1.10a	17%
Dividends	$0.20	$0.48	$0.60	73%

a-After preferred dividends.

PNV achieves its high net cash flow results compared to general accounting EPS by somewhat higher leverage in joint ventures and major tax savings owing to



its origin via a spinoff. This means properties have negative basis for taxes but much higher book value. Property sales in a venture added 53¢ to 1986 GAAP income but aren't included in PNV's operating cash flow computations.

Assets and Operations: PNV owns directly properties with $90.9 mil. cost and has joint venture interests in properties with $34 mil. cost, including some development projects. Holdings include offices with 577,500 net SF, 97% occupied; industrial/business parks with 426,400 net SF, 95.3% occupied; and net 630 apartments, 99% occupied. Major holdings are 43.9% interest in 481,000 SF Alcoa Bldg., San Francisco; 44.7% in adjoining 1,254 Golden Gateway Apts. Ventures are developing 468,000 SF Rincon Ctr. in San Francisco; 610 DU Southwest Villages apts. in Phoenix; and 306-DU Radisson Suite Hotel in Tucson.

Financial Measures - B: Debt of $74.2 mil. is 17 times $4.4 mil. equity at cost and 0.8 times $94.3 mil. equity at current value, both including $16.5 mil. preferred stock. The $1.10 preferred is convertible into 0.625 common shs. Current Value: PNV's appraised value is $21.57/sh. fully converted, up 12% in the year.

Exposure - B: PNV's goal is to use cash flow from its seasoned San Francisco properties to build value in new projects, most via joint ventures. Record to date has been impressive and shares at a discount to current value are strong longer-term holds. The preferreds ($12.38--ASE) at a 15.6% conversion premium are the conservative play.

Reading Company ($15.88 - OTC) retains C Rank. A former railroad which

emerged from bankruptcy in 1981 as owner of major properties in Center City Philadelphia, RDGC is expanding into energy and manufacturing in an effort to use its $177.3 mil. ($35.38 sh.) net operating loss carryforwards.

EPS/Dividends - B (Dec. yrs):

	1985A	1986A	1987E	3 Yr.%
EPS/Oper...	$0.21a	$0.57	$0.65	76%
Gross CF*..	$0.43a	$1.00	$1.25	70%
Dividends..	None	None	None	

a-Plus 21¢ extra gain. * Net income plus imputed Fedl. income tax.

RDGC income included $1.59/sh. pretax gain on sale of investments in 1986, vs. no such item in 1985.

Real Estate Assets and Operations: RDGC received $26 mil. in 1986 previously escrowed in the 1985 sale of a 600,000 SF office it developed in Center City's Market East area. RDGC guaranteed cash flows thru 1990 and reports about 90% of space now leased. Part of RDGC's Philadelphia land holdings will be included in a proposed convention center, approved by the state legislature in 1986. In Mar. RDGC agreed to sell about 7 of its 13 Center City acres for the new convention center; RDGC will get (a) $19 mil. net cash plus use of existing basement space for parking; (b) 7-year option to buy two adjoining sites zoned for 800,000 SF offices; and (c) named as developer of 22 urban renewal acres near Philadelphia's airport. In Center City, RDGC also plans to renovate the historic Reading Terminal Headhouse and improve Reading Terminal Market.

Other Operations: RDGC is building two co-generation plants to generate 65 megawatts of power for sale to public utilities. Ground was broken in 1986 for a Pa. plant set for 1989 completion, and completion of a Calif. plant is expected in 1987; total cost is $158 mil. RDGC's half interest in an 18,000 bbl./day refinery in El Paso, bought in April 1986, resulted in a small loss.

Financial Measures - C: Debt of $122 mil. is 2.7 times $45 mil. shareholders' equity at cost, equal to $8.93/sh. Debt includes $103.5 mil. industrial revenue bonds sold to finance co-generation plants. Liquidity still relies heavily upon asset sales.

Current Value: RDGC hasn't appraised its asset value but the pending sale of some Center City Philadelphia holdings at about $58 per SF puts about $6.50/sh. potential value on book value. A block of common and warrants in Clevite Industries, carried at zero value, was sold for $8.8 mil. ($1.75/sh.). Other assets and the taxloss benefits add $5-$10 per share in our view, or total value of $23-$25/sh.

Exposure - C: RDGC is entering some unfamiliar businesses to use taxlosses. So far results have been generally impressive, altho co-generation plans haven't come on stream and the refinery is lackluster to date. RDGC's Center City properties are in a rundown area which city fathers want to upgrade enough to spend $500 mil. for the convention center and adjoining hotel. In Manhattan similar construction has triggered a building boom and we expect the same in Philadelphia. Shares remain in our Portfolio Selector as an aggressive buy.

COMPARATIVE REALTY STOCK GROUP AVERAGE 07/07/87

GROUP NUMBER & NAME	DIV	NON-DIV	TOTAL	SHARE (000)	BOOK VALUE	ANNUAL DIV	EARN ANN	LAST PRICE	-% CHANGE FROM JUN 23	JAN 1	P/E RATIO	ANNUAL YIELD	% PR TO BK	RETURN ON BK	MARKET VAL(000)
1 PROPERTY REITS	55	3	58	6850	10.87	1.12	1.07	15.18	1.4	2.5	14.1	7.4	39.6	9.9	6732.3
2 PROP & MTG COMB REITS	23	3	26	5790	12.85	1.35	1.04	13.88	0.5	-4.2	13.3	9.7	8.1	8.1	2195.8
3 MORTGAGE REITS	17	1	18	5668	13.99	1.81	1.52	14.34	0.5	-4.9	9.4	12.6	2.5	10.9	1546.4
4 PARTICIPATING MTG REITS	13	0	13	8587	11.45	1.09	0.98	10.78	0.7	-12.7	11.0	10.1	-5.8	8.5	1423.6
5 MAJOR HOMEBUILDERS	8	4	12	21177	9.22	0.30	1.13	13.89	-7.1	0.9	12.3	2.2	50.6	12.2	3025.4
6 OTHER BLDRS/DEVELOPERS	5	29	34	6330	5.11	0.13	0.27	8.13	-0.1	7.5	30.4	1.5	59.0	5.2	1918.2
7 INCOME PROP BLDR/OWNR	22	12	34	7476	11.08	0.76	0.92	16.00	0.0	1.5	17.4	4.7	44.4	8.3	3905.9
8 MORTGAGE BANKER/FINANCE	13	4	17	13764	10.32	0.86	1.13	14.13	-2.5	-4.5	12.5	6.1	36.8	11.0	5200.2
9 DIVERSFIED RLTY&HOLDING	13	5	18	18363	15.45	0.36	1.44	19.39	2.9	19.0	13.5	1.8	25.5	9.3	11284.6
10 RLTY SVCS/SYNDICATORS	1	5	6	8256	5.81	0.03	0.22	9.73	1.7	24.9	43.9	0.3	67.4	3.8	440.4
11 MANUFACTURED HOUSING	4	6	10	8910	6.68	0.15	0.33	9.63	-3.5	-3.5	29.4	1.5	44.2	4.9	1195.9
L LIQUIDATING COMPANIES	0	1	1	5968	1.08	0.00	-1.31	2.38	0.0	-9.5	NC	NC	119.9	NC	14.2
P PREFERRED STOCKS	1	0	1	1650	10.00	1.10	0.00	12.38	5.3	2.1	NC	NC	23.8	NC	20.4
OVERALL AVERAGE			248	8895	10.49	0.83	0.95	13.70	0.1	1.9	14.5	6.0	30.5	7.9	38903.4
DOW JONES INDUSTRIALS							126.49	2449.78	0.4	29.2	19.4	2.8			
STANDARD & POOR'S 500							15.24	307.40	-0.3	26.9	20.2	2.9			
DOW JONES UTILITIES							13.85	205.49	-1.3	-0.3	14.8	7.8			